

MINUTES
BOARD OF TRUSTEES OF THE
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, Indiana 46204
June 29, 2006

REGULAR SESSION

Board Members Present

Ken Cochran, Chair
Chuck Schalliol, Vice Chair
Kathy Ettensohn
Bob Welch
Regina Overton
Matt Murphy

Board Members Absent

None

Others Present

Tony Armstrong, Office of Management & Budget
Chris Ruhl, Office of Management & Budget
Jim Bosserman, Ernst & Young
Greg Stack, State Budget Agency
Peter Keliuotis, Strategic Investment Solutions, Inc.
Doug Kryscio, Mercer Investment Consulting
Iliana Nikolova, Mercer Investment Consulting
Brendan Morrison, CitiStreet

PERF Staff Present

David Adams, Executive Director
Terry Magid, Chief Operating Officer & Deputy Director
Dave Huffman, Chief Technology Officer & Deputy Director
Shawn Wischmeier, Chief Investment Officer
Steven Barley, Director of Benefits
Erin Hankins, Executive Assistant to the Executive Director
Jayelynn Willman, Executive Assistant to the Board

Meeting called to order at 1:02 by Chairman Cochran.

I. Approval of Minutes

MOTION duly made and carried to approve the minutes from the April 21, 2006 board meeting with typographical changes.

*Proposed by: Kathy Ettensohn
Seconded by: Matt Murphy
Votes: 6 in favor, 0 opposed, 0 abstentions*

MOTION duly made and carried to approve the minutes from the May 24, 2006 board retreat with typographical changes.

*Proposed by: Bob Welch
Seconded by: Kathy Ettensohn
Votes: 6 in favor, 0 opposed, 0 abstentions*

II. Old Business

- **Audit Update**

Mr. Magid reviewed with the board events that have taken place since PERF received a qualified opinion from the State Board of Accounts (SBOA) for FY05. Mr. Magid noted that the primary driver of that qualification was lack of adequate reporting of employer reserves and internal controls; some of the repeat findings have been noted for 8 years. Mr. Magid noted that in less than three months PERF had reduced the number of findings from thirty to fifteen. Mr. Magid discussed that due to lack of resources and expertise that outside assistance was sought. Due to timing, the special procurement process was used to select Ernst & Young.

Mr. Magid introduced Jim Bosserman from Ernst & Young (E&Y) to provide a status to the board. Mr. Bosserman stated that E&Y is focusing on employer reserves and internal controls. Mr. Bosserman discussed that the SBOA agrees with the aggregate balances but a plan is needed for each of the specific employer reserves. Mr. Bosserman discussed that a methodology for determining the employer reserves is being developed.

A detailed time line has been put together for the audit process. The target close date for the FY06 audit is October 21, 2006.

Charles Schalliol noted that PERF should be commended for making the SBOA findings a priority.

III. Executive Director Report

Mr. Adams reviewed the customer service improvements PERF has made since June 2005:

- The fund has grown approximately \$1.3 billion.
- The time to complete a refund has been reduced by 68%
- 19% of all transactions are completed electronically.
- The backlog of retirement applications has been eliminated.
- The average number of days from retirement to first check has decreased 33%.
- PERF has trained employers on how to electronically transact with PERF.

Mr. Adams outlined the major initiatives to take place at PERF over the next year, presented an updated scorecard for FY07 and organizational chart. The major initiatives are:

- Continue to focus on high quality alternative investment opportunities.
- Review the results of the Asset Liability Study and present recommendations to the board for approval.
- Hire a Director of Retirement Services that will focus on all aspects of retirement.
- The process for collecting and calculating service credit will be reviewed.
- Enhance the business technology and begin the development of a plan to replace SIRIS.
- Continued implementation of a control environment.
- Implementation of PeopleSoft financials.
- Staff will work with outside services to create a compensation structure and continue personnel development and improvement.

IV. New Business

- **Resolutions related to Legislation**

Chris Ruhl, Policy Director for the OMB, represented PERF's legal team at the board meeting. Andrea Unzicker's, PERF's General Counsel, was unavailable due to a conference.

Resolution 06-02 delegates review of default impairment awards from the board to the Executive Director. This relates to SB 57 which authorized PERF to review default impairment awards.

MOTION duly made and carried to approve Resolution 06-02.

Proposed by:
Seconded by:
Votes:

Kathy Ettensohn
Chuck Schalliol
6 in favor, 0 opposed, 0 abstentions

Resolution 06-03 delegates certain duties from the board to the Executive Director in the area of retirement benefits for state employees who are terminated as a result of privatization.

MOTION duly made and carried to approve Resolution 06-03.

Proposed by: Regina Overton
Seconded by: Matt Murphy
Votes: 6 in favor, 0 opposed, 0 abstentions

Resolution 06-04 delegates review of default impairment awards for the Excise Police, Gaming Agent and Conservation Officers Plan from the board to the Executive Director.

MOTION duly made and carried to approve Resolution 06-04.

Proposed by: Matt Murphy
Seconded by: Chuck Schalliol
Votes: 6 in favor, 0 opposed, 0 abstentions

- **Investment Update**

Investment Update

Shawn Wischmeier provided the board with an Investments update. Year-to-date performance through the end of May was 3.6%, down from the 5.2% year-to-date through the end of March.

Investment Manager Change

Mr. Wischmeier reviewed Hughes Capital Management. Hughes has been with the fund since 1994. At that time, they were asked to manage a longer term fixed income mandate against the Lehman aggregate. During 2004, a move was made by the board to move them to a shorter term mandate. In 2005, the Ohio Bureau of Workers Compensation (OBWC) terminated all of their active managers making PERF Hughes' largest relationship representing 13% of Hughes' total assets at the end of May. Given these developments and previous history, PERF met with Hughes at the PERF building in April and visited Hughes at their office in May.

Doug Kryscio reviewed what Mercer looks for in managers and how their performance is measured focusing on five key points:

- Ownership Structure
- Financial Staff and Turnover
- Performance Attribution
- Concentration of Assets

- Client Service Issues

Frankie Hughes owns 100% of the firm. The concern is her ability to attract and retain investment professionals. Hughes consists of only five people. Two investment professionals handle 11 mandates. Mercer is not only concerned that PERF is 13% of Hughes' assets, but also the different type of portfolios Hughes is managing. The Investments staff and Mercer agreed to put together recommendations of improvements they'd like to see from Hughes.

Mr. Wischmeier noted that staff and Mercer have agreed to give Hughes until September 15th, 2006 to implement changes. At that point, Mercer and staff will visit Hughes again and report back to the board any progress that has been made.

Matt Murphy noted some concerns with the timeline and suggested that recommendations be put forward to Hughes and progress be evaluated.

Chuck Schalliol felt it would be helpful to have feedback from Hughes on the timeline and length of time to implement changes.

The board agreed to have the investment staff and Mercer meet with Hughes about these recommendations. Staff and Mercer will report back to the board on Hughes progress at the October meeting.

ASA Guaranteed Rate Approval

Mr. Wischmeier reviewed that the Guaranteed Fund is one of the ASA options at PERF. The Guaranteed Fund is unique from other ASA options in that the board sets the rate. The board must set this rate once each year. The rate is the average of the last five years returns on PERF's main pool of assets (CRIF). The new rate going forward, based on the approved methodology, is 6% starting July 1, 2006.

MOTION duly made and carried to approve the Guaranteed Rate at 6% starting July 1, 2006.

Proposed by:

Bob Welch

Seconded by:

Matt Murphy

Votes:

6 in favor, 0 opposed, 0 abstentions

House Investments Approval

Mr. Wischmeier discussed a proposed investment with House Investments. House Investments is an Indiana based firm with \$400 million in investments. Their investments typically involve providing capital to building companies to complete construction projects for condos, buildings, multi-family complexes, etc. House provides both equity and debt financing. The top three partners at the firm have an average of over 20 years with House. PERF made a commitment of \$11.44 million to House Fund III in 2004 which represented 25% of that fund. PERF has received a 17.5% net rate of return to date.

House is raising Fund IV and PERF staff and Strategic Investments Solutions (SIS) are recommending an investment of up to \$5 million based upon House's ability to raise \$30 million. This will also reduce PERF's exposure to House from 25% to 21%.

Mr. Schalliol recommended that the board approve committing at a rate of 16.67% of raised capital up to \$5 million with House.

Chairman Cochran and Mr. Murphy must abstain from voting due to having direct investments with House.

MOTION duly made and carried to approve committing 16.67% of raised capital up to \$5 million investment with House Investments Fund IV.

<i>Proposed by:</i>	<i>Chuck Schalliol</i>
<i>Seconded by:</i>	<i>Bob Welch</i>
<i>Votes:</i>	<i>4 in favor, 0 opposed, 2 abstentions</i>

Re-Balance Memorandum

Mr. Wischemier stated that PERF's Investment Policy Statement (IPS) requires staff to report the status of the different policy allocations versus their ranges.

Mr. Wischmeier explained that core fixed income is outside the range but PERF staff recommends not rebalancing until the completion of the asset-liability study in August.

Mr. Adams, Chairman Cochran, Mr. Wischmeier, and Doug Kryscio of Mercer signed a memo allowing the portfolio to stay unbalanced pending the asset liability study.

- **Benefits**

Benefits Update

Steven Barley provided the board with a Benefits update. He compared the old PERF environment to the current environment. He summarized the key results his departments had achieved and detailed their ongoing focus. He also provided the board with charts his team uses to track progress.

Mr. Adams commended Mr. Barley and his team for doing a tremendous job. If members follow the Bridge to Retirement brochure they will not see an interruption in payment.

New Units & Enlargements

Mr. Magid discussed with the board that twice a year the board is asked to approve new units and enlargements. These are new groups that want to join PERF for the first time or current PERF covered groups that want to add additional PERF covered positions.

MOTION duly made and carried to the new units and enlargements.

<i>Proposed by:</i>	<i>Bob Welch</i>
<i>Seconded by:</i>	<i>Regina Overton</i>
<i>Votes:</i>	<i>6 in favor, 0 opposed, 0 abstentions</i>

Finance & Budget

Financial Update

Mr. Magid reviewed the financials with the board. PERF continues to operate under budget.

Budget Approval

Mr. Magid reviewed the proposed budget for FY07. PERF decreased the budget by 7%. PERF plans on keeping the same headcount the same as approved in FY06. PERF has set aside \$3.5 million to improve internal controls.

MOTION duly made and carried to approve the budget for FY07.

<i>Proposed by:</i>	<i>Regina Overton</i>
<i>Seconded by:</i>	<i>Chuck Schalliol</i>
<i>Votes:</i>	<i>6 in favor, 0 opposed, 0 abstentions</i>

V. Date of Next Meeting

August 18, 2006 at 1pm

VI. Adjournment

Adjourned at 3:20pm.